DOW THEORY LETTERS INC.

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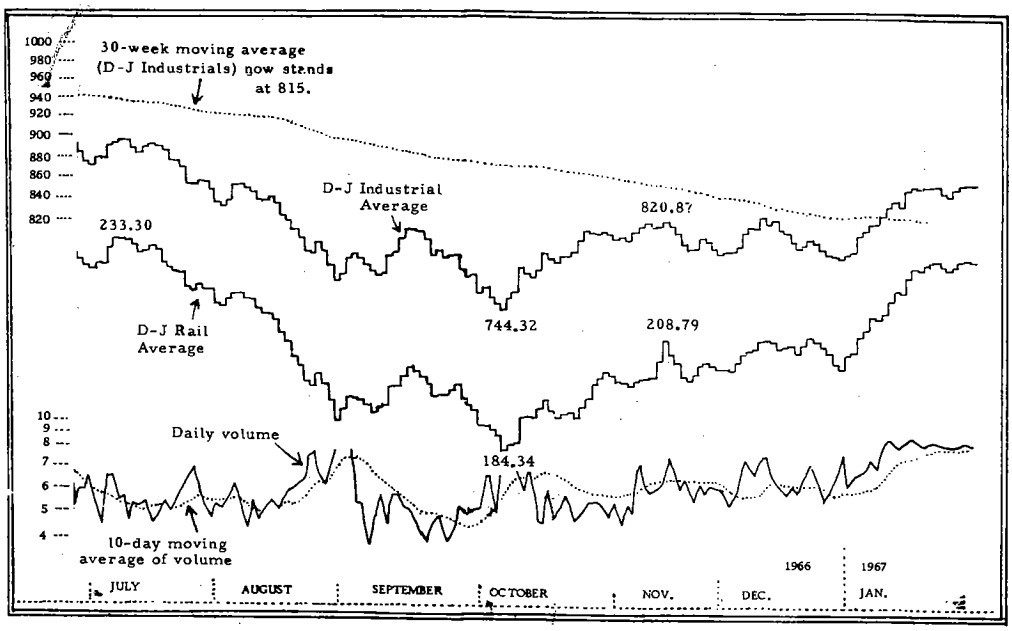
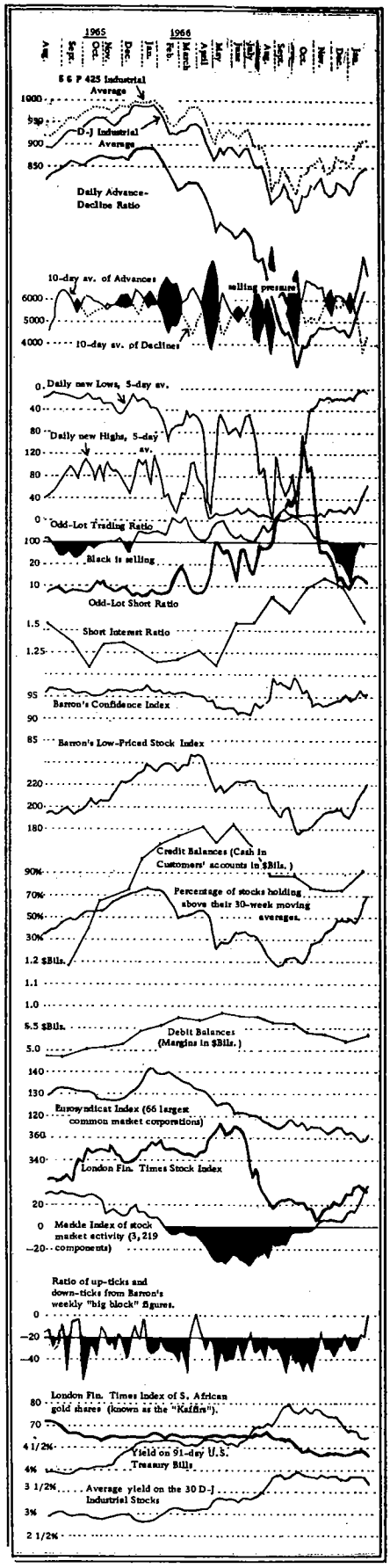
THE MARKET: Volume (on the basis of a 10-day moving average of volume) touched 10.6 million shares on January 25, and volume is, at this writing, still running above 10 million shares. This is the highest volume in the history of the New York Stock Exchange. There is no question about the speculative nature of this market. In all sectors, the American Exchange, the bond market, the over-the-counter market, the impression is that "a new bull market is on." From all accounts, the experience of 1962 and thereafter is to be repeated, and in due time the Averages are to advance into new high ground. Fewer and fewer investment advisors are ready to concede that a primary bear market is in progress, and most of the formerly bearish advisors are now suggesting the purchase of at least a few shares for "the rise ahead."

The history of past bear markets indicates that these markets are out to break the investor. Bear markets have a way of first wiping out the stockholder on the downside, then turning to rend the shorts on the way up (all the while gathering a new flock of bulls to the fold). When the shorts have covered and taken their losses, and when the new contingent of bulls are well-loaded with wares, the bear market starts down again, and the whole process is repeated. Finally, the stockholder becomes discouraged, and he leaves Wall Street. One indication of this is a major decrease in trading volume. By the same token time the speculator (be he short or long) is ultimately defeated. One of the best checks on the demise of the speculators is a large decrease in debit balances (i.e. margin accounts), the speculator's "most important tool."

In the past extremely high volume within the framework of a bear market has not been bullish. In May and June of 1913 extremely high volume at the bottom of a primary bear leg accompanied a secondary upward correction, but by the end of the year prices were at new lows. Heavy January volume in 1914 occurred at the top of a bear rally, and that high volume appeared simultaneously with the high prices of that year. In March and April of 1920 heavy volume came at the top of a secondary within a bear market, and here again the volume signified the high for the year. Record volume appeared in March and April of 1930 during a giant rally in the bear market. The peak prices arrived in April. Extremely heavy volume showed again in February of 1931, and this corresponded with the highs for that year.

In September of 1939 volume boomed to 5-6 million shares per day, and this marked the high level of prices for the following 4 years. In May of 1948 volume surged from an earlier




1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily Advance-Decline Ratio
10-day av. of Advances
selling pressure
10-day av. of Declines
Daily new Lows, 5-day av.
Daily new Highs, 5-day av.
Odd-Lot Trading Ratio
Black is selling
Odd-Lot Short Ratio
Short Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index (66 largest common market corporations)
London Fin. Times Stock Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's weekly "big block" figures.
London Fin. Times Index of S. African gold shares (known as the "Kaffirs").
Yield on 91-day U.S. Treasury Bills
Average yield on the 30 D-J Industrial Stocks

1 million shares per day to 5 million shares. This occurred within one month of the 1948 peak, to be followed by a decline to the June, 1949 lows. Most recently, the week of April 11-15, 1966, registered the heaviest volume in Exchange history. This was followed by a decline (starting about 3 weeks later), and by new lows in the Averages (below the 1965 lows) during July.

All of the aforementioned instances were examples of high volume which appeared within primary bear markets. I list these occasions to show that heavy volume is more often than not an adverse indication during a bear period. Although in each instance the heavy volume seemed to be a hopeful manifestation, each of these in retrospect proved to be just a trap in a continuing primary decline. Real primary bull markets usually advance in a deceptively innocent way, with volume indications even and undramatic. This is particularly true at and around the beginnings of new primary bull markets.

VIETNAM: The writer was one of the first to see the danger in the Vietnam war. In terms of both political strategy and economic consequences, I have always felt it was a disaster. In the January 27 issue of Life appears the best short article I have yet read on Vietnam ("Notes on a Monstrous War" by Robert Sherrod). Sherrod talks about the unbelievable costs of the war, a war which he estimates cost us $400,000 for each of the enemy we kill. Sherrod quotes a colonel as saying, "I had a dream the other night, I dreamt the war here in Vietnam cost us more than World War II." (World War II cost the U.S. $350 billion). Last year the U.S. spent $20 billion in Vietnam and the costs are going up. Could the colonel's fantasy turn out to be true?

A few interesting quotes: "Literally everything is Texas-sized, from the new 'Pentagon West' ($25 million), which will provide offices for most of the 68 American generals stationed in Saigon, to a cantonment for 60,000 troops under construction at Long Binh ($90 million). Both projects should be ready for occupancy this fall.

"In World War II the engineers or Seabees would level a 3,000-foot strip of topsoil, lay some pierced steel plank and report the airfield ready to receive planes. With jet planes it's different. Jets need dust-free, 10,000-footlong strips of aluminum or concrete—which cost $5 million or more. We have built nine new jet landing fields between Da Nang and Saigon. The total number of airfields in South Vietnam is now 282, one of the highest in the world. Will these become the Stonehenges—or, more appropriately, the Angkor Wats—of Vietnam, the relics of a civilization which passed that way? Or will the Vietnamese dig up the concrete so that rice can be planted here again?"

Perhaps the best picture of Vietnam comes from the sundry quotes which Sherrod includes in his article: "A private in Saigon: 'The only thing to do is to kill everybody in the country over five years old.'

"A sergeant in Cu Chi: 'We ought to take over the country—the hell with these Vietnamese generals and politicians—win the war, then give it back, like we did in Korea.'

"An AID man in Quang Nam province: 'We can't even slow down the Vietnamese truck drivers. How can we expect to change the generals and province chiefs?'

"A sailor in My Tho: 'Pretty soon we'll have the country paved over. Then we won't have to worry about it any more.

"A facetious reporter: 'General Westmoreland, there are 15 million people in South Vietnam. We put that many people in uniform in World War II. Why not mobilize enough troops to give every South Vietnamese a personal American bodyguard?' "

Sherrod's summing up offers little hope, in the face of the way things are now going: "After nearly two months in Vietnam I find this the most hateful war we have ever fought. Surely, we never would have got into it if we had known how deep was the well, but we are the victims of one tragic miscalculation after another. We find ourselves supporting a government of mandarins with little basis of popular support, fighting for an army that has little inclination to do its own fighting.

"Yet in all candor I see nothing to do except continue on the course we now pursue, hoping that a merciful Providence will show us a way out. We have committed our national honor to defend our policy and our allies. The key question is the one asked so often by Lyndon Johnson, 'What would you do?' At this point it makes no sense to say 'Give up,' or to ask 'Why did you do what you did?'

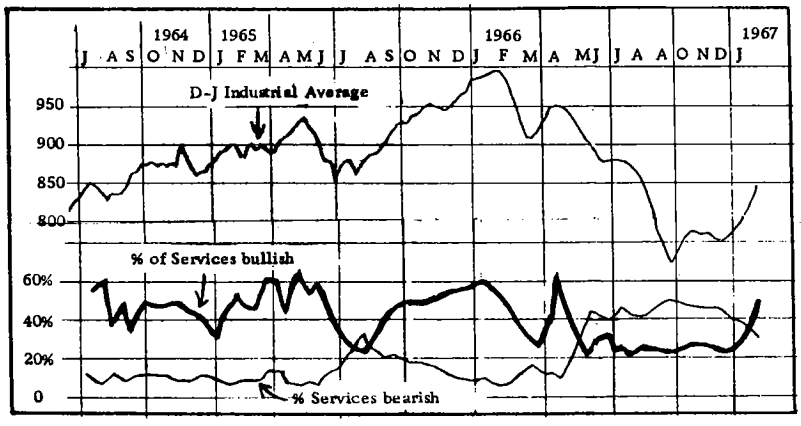
"Let us pray."

It is my opinion that before 1967 is out both the short sellers and the stockholders will be nursing their wounds. Bear markets work that way. They create pessimism to separate the stockholders from their equities—with losses; then they create optimism to drive the shorts out—with losses. In the end, the patient investor, the man who has taken shelter from the storm, is the man who is most apt to come out ahead by the time the bear market is over.

ADVISORY OPINION: The accompanying chart is based on Investors Intelligence's (Larchmont, N.Y.) tabulations of the opinions of 67 investment services. I last presented this chart in Letter 321 (April 25, 1966). At that time 64% of the services were bullish and only 11% were bearish. This occurred right at the top of the April bear rally, and the condition was followed by a major decline.

As seen on the chart, professional opinion became lop-sidely bullish in April-May of 1965, prior to a sharp drop; again in February, 1966, just as the primary bear market began, and once more in April of 1966 as described above.

Investors Intelligence notes in its latest bulletin that advisory opinion has jumped from 29% bullish on January 11, 1967 to 50% bullish on January 25. During the same period bearish opinion declined from 37% bearish to 30% bearish. We are rapidly approaching the point where professional opinion is too heavily on the bullish side. Within a primary bear market I would not expect bullish opinion to climb quite as high as previously, nor would I expect bearish opinion to drop as low as before. It seems to me that when 50% of the services turn bullish within a bear market (such as has now occurred) the situation is becoming dangerous. This rally should be nearing the topping out area, based on a "contrary reading" of investment advisory opinion as shown on the chart. Remember, Hamilton noted that he had never known the majority of professional opinion to be correct.



ECONOMY: The auto complex comprises one of the most important industries in the nation. One out of every seven workers in the U.S. works at a job which depends directly or indirectly on the auto industry. With sales of 8 or 9

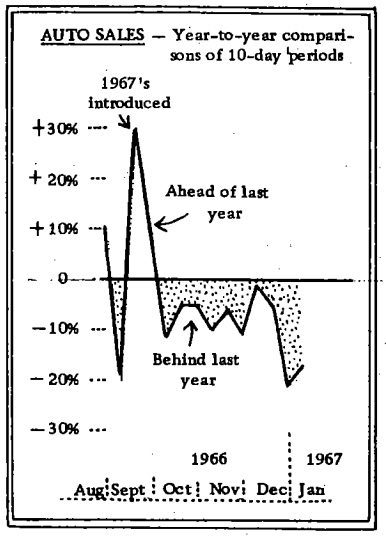
million cars a year at prices of $2 thousand per car and up, it takes little figuring to see what a huge chunk of the national economy the auto business represents. The auto market, moreover, is a sensitive indicator of both consumer buying attitudes and overall economic conditions in the U.S.

The first real test of the automotive market comes each year in January. But economist Eliot Janeway said it better than I could in his latest Janeway Letter. January is test-time for autos, he writes, and that is the time "....when dealers start beating the bushes to sell new cars: and, of course, the way they do it is by taking in used cars. Consequently, the specific sector of which market pressure is concentrated when the January test comes is the used car market. It has just buckled. As the price of holding new car sales within 20% of the 1966's start-up level, the dealers are finding themselves obliged to slash prices in order to move the inventory they have been taking in. Years in which January goes bad in the used car market invariably turn out to be leaner years."

Chrysler, GM To Lay Off 16,000 Men

DETROIT (UPI) — Chrysler Corp. and General Motors Corp., caught in an auto industry sales slump, announced yesterday they would lay off nearly 16,000 workers in a seven-plant production cutback.

January auto production was originally scheduled to drop 12% below the January, 1966 rate. But since those earlier plans, the latest (January, 1967) car sales statistics have been tabulated. They are a shocking disappointment to the auto industry. The writer keeps a number of key economic charts. One of the most interesting is a chart of the year-to-year changes in auto sales (based on the widely-followed 10-day periods). That chart is now telling a rather grim story. In the last quarter of 1966, auto sales were lagging 1965's figures by about 6%. But in the first two 10-day periods of January, 1967, sales dropped an average of 19% behind previous year sales. As seen on the chart, the ten most recent 10-day periods have been on the minus side of the chart, which means they have run below the comparable year-ago periods.



What happens next? Statistics for the last 10-day period of 1967 are not yet in, but with earlier production cut-backs of 12% in effect, and with sales in January (so far) dropping 17% behind 1966, it is obvious that (1) either further production cut-backs will be necessary or (2) auto sales will have to pick up. The answer may have been given last week, and that answer made the headlines. I include a clip from United Press which is self-explanatory.

Again I want to emphasize that this is a primary bear market and that bear markets are invariably international in scope. The slow-down in car sales has also hit Europe, and the result has been lay-offs in France, England, Sweden, West Germany and Belgium. This slowdown in European sales can be counted upon to produce vicious foreign car competition in the U.S., for the U.S. is where the big market is. When the European market stumbles, every producer looks to the U.S. to keep his plants going. The last clip (bottom of page) shows what is occurring in Europe, but it appeared two weeks ago and is already outdated. Latest statistics indicate that Britain's unemployment rate has now jumped to around 2.5%

Why am I taking this time to write about autos in detail? The reason is that I want subscribers to understand that in a primary bear market (as in a bull market) one event leads to the next. What if auto sales continue their unexpected trend, and sales run 20% to say 30% behind 1966 for all of 1967? What if this is a 6 to 7 million car year instead of an 8 to 9 million year? The implications for profits and production in half the industries in the nation could be changed. These changes would be unexpected and unplanned for.

A drop in corporate profits would be a particularly unpleasant prospect for the U.S. Government, which is planning on pre-tax corporate profits of about $83 billion this year. But suppose those profits were to decline 25% to $61 billion instead? It could make a difference of $8 billion in Government receipts, this in the face of a year in which the Government plans for a budget deficit of "only" $8 billion. In the last Letter I wrote about what could happen in the bond market if the U.S. budget deficit runs wild. In Letter 346 I quoted former Budget Director Maurice Stans to the effect that a recession in the face of today's spending could produce a budget deficit of $30 to $40 billion in fiscal 1967-68. I think that there is going to be a recession during the year ahead, and that Stans is going to be right about the deficit. But what the repercussions of such a deficit is going to be is too much for me to guess. Except in one area—the money market. To finance a $30 to $40 billion deficit the Government is going to have to go into the money market. If they do that, they are going to run interest rates right through the roof. All these possibilities the market is going to have to absorb during the year or so ahead.

One important factor in the current economic situation should be fully understood. That is the overriding importance of the private sector of the economy. The Government's total contribution to the Gross National Product has been running about 10% to 11%. In other words, almost 90% of the GNP comes from the private sector. Thus, a 3% drop in GNP can wipe out a 30% gain in Government spending. As Noted by George Shea in the January 30 Wall Street Journal, sales in the private sector of the economy actually fell off during the 4th quarter of 1966. This trend, if it continues, could represent a most serious situation for the U.S. overall economy.

EUROPE'S JOBLESS CREATE NEW WOES

Unemployment Now Termed Problem in a Region Long Used to Labor Shortage

BRITAIN'S RATE AT 1.5%

West Germany Also Shows Gain and France Records a High for 12 Years

By RICHARD E. MOONEY
Special to The New York Times

PARIS, Dec. 18—In Britain the rate of unemployment has risen to more than 1.5 per cent. In West Germany the number of vacant jobs has dropped to the point where it is only double the number of jobless workers. In France the number of unemployed has climbed to a 12-year high.

WHERE TO FIND IT: I have received an increasing number of requests for a list of both books and periodicals which might be of use to investors. I have wanted to publish such a list, and here is a start (more to come in succeeding Letters).

Wall Street Journal and Barrons. The daily and the weekly published by Dow Jones & Co. These two are so widely known and so essential that I will not offer any comment except to state that they are "musts" for every investor.

The Exchange Magazine (11 Wall St.) published by the N.Y.S.E. is an interesting little monthly publication. Worth reading for its well researched articles on the market and on individual industries.

Financial Analysts Journal (80 Federal St., Boston, Mass. 02110) A good collection of articles, many constituting original research in the market or in economics. The material here is often too specialized for the average reader, much of it is also too theoretical.

Magazine of Wall Street (120 Wall St., N.Y.C.) An interesting magazine. I read it, and usually get something out of it. However, I find that I can seldom reach a conclusion from the articles in this magazine.

Financial World (17 Battery Place, N.Y.C.) A weekly. The articles are short, concise, and, I feel, rather incomplete. I lost interest in this one.

Forbes (70 Fifth Ave., N.Y.C.) The best of the monthlies for my money. Good reporting, often in depth. Interesting columns by well-known financial analysts in the back of the magazine.

Economist (25 James's St., London SWI) a gem of a magazine, weekly from London. Provides an excellent view of the world from the economic standpoint. Despite their pro-Keynesian and pro-Labor view, I find this publication essential for an understanding of what's going on around the globe. Plenty of original reporting in this one.

The Commercial and Financial Chronicle (25 Park Place, N.Y.C. 10007) A weekly for $24 per year. Many interesting and original articles on all facets and branches of Wall Street economics. Many columns and articles on individuals companies and industries.

World Business, sent free bi-monthly by Chase Manhattan Bank, 1 Chase Manhattan Place, N.Y.C. 10015. Many excellent articles on world business and finance, augmented by clear, well drawn charts and graphs.

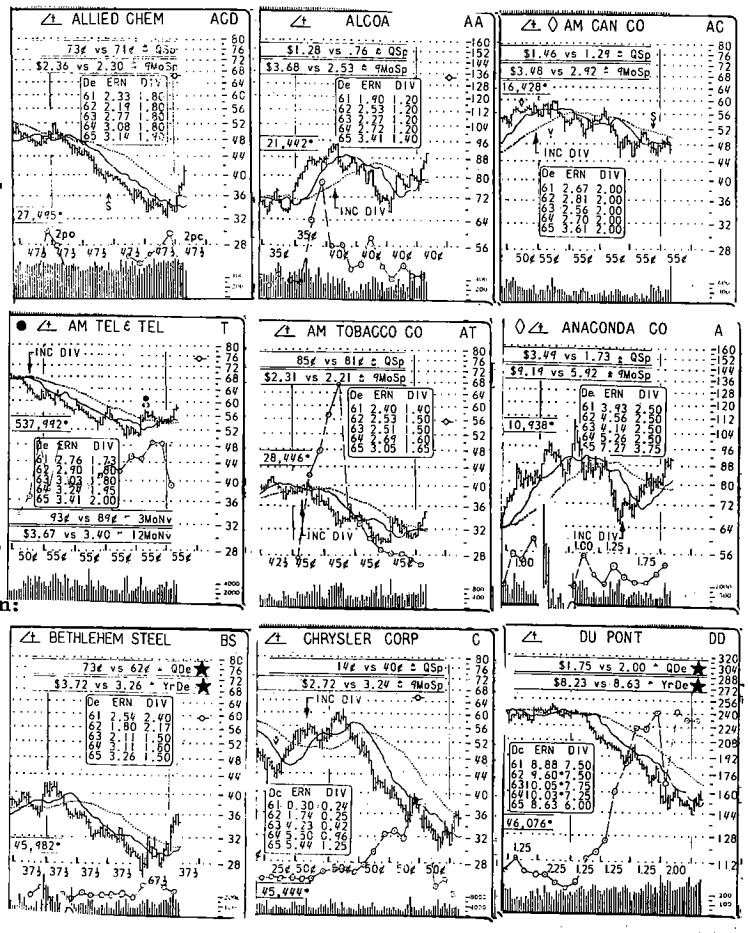
Official Summary of Security Transactions (U.S. Gov. Printing Office, Wash., D.C. 20402) A listing of all stock transactions by directors, officials, etc. The "what's what" of insider buying and selling. Issued monthly, and well worth studying.

Federal Reserve Chart Book (Federal Reserve System, Wash., D.C. 20551) A bargain package of monthly charts covering many segments of the economy including bank credit, money supply, real estate, prices, int. trade, business finance, money rates, etc.

Business Cycle Development (U.S. Printing Office, Wash., D.C. 20402) Another bargain in charts of business indices including leading indicators, coincident indicators, lagging, diffusion indices, international comparisons, etc. A real education here.

LATE NOTES: During the last 12 days the market has been "churning" in the 840-850 area. Volume during the 12 days has totaled a fantastic 125 million shares. This is a tremendous amount of fuel under the market boiler without appreciable movement, and it suggests that for the first time in 1967 supply and demand have come into equilibrium. Apparently, as many investors are taking profits as are now entering the market for new commitments. Thus the fiercest battle between the bulls and the bears since the rally began is now on.

STOCKS: I thought it would be interesting to examine the action of a number of individual stocks to see if we could detect what has been happening. I wanted to examine the leaders, the biggest investment stocks on the Board. To avoid prejudice in selection, I took the first few stocks in the Dow Average in alphabetical order.



Allied Chem. after a long bear market decline, has shot straight up in typical bear rally fashion from a small base. Alcoa is more impressive and is nearing its 1966 high again. Amer. Can appears to be still under distribution and the stock is flirting with its 1966 low. Amer. Tel., after a major decline, is working its way back but has not yet retraced half its 1966 losses. Amer. Tobacco has formed a good base, but so far progress on the upside has been slow and unimpressive. Anaconda, like Alcoa, is pushing for its 1966 high again but running into heavy supply. Beth. Steel is rallying from a small base in typical bear market rally fashion. Chrysler has done very little and appears to be under continuous distribution. DuPont is one of the most sluggish stocks on the Board and is essentially at its 1966 low, despite the general market rally. Conclusion: you would have made money with 3 out of these 9 Dow stocks if you had bought them on the lows. The other 6 would proabably have you, as a speculator, sweating about now. (Charts courtesy, Ouote Digest, 110 N. Lorraine, Wichita, Kansas).